

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Nora Mead Brownell, and Suede G. Kelly.

FirstEnergy Solutions Corporation

Docket No. ER06-117-000

ORDER ACCEPTING AND SUSPENDING REQUEST TO MAKE AFFILIATE
SALES, SUBJECT TO REFUND, AND ESTABLISHING HEARING PROCEDURES

(Issued December 29, 2005)

1. In this order, we will accept and suspend for a nominal period FirstEnergy Solutions Corp.'s (Solutions) request that it be permitted to make sales to its affiliates The Cleveland Electric Illuminating Company, Ohio Edison Company, and the Toledo Edison Company (collectively, the FE Ohio Operating Companies) and Pennsylvania Power Company (Penn Power)¹ as discussed herein, subject to the outcome of a hearing, effective on January 1, 2006, and subject to refund.²

2. FE Ohio Operating Companies and Penn Power are providers of last resort (POLR) in their respective states. Solutions requests authorization to make power sales to the FE Ohio Operating Companies under a Rate Stabilization Plan approved by the Public Utilities Commission of Ohio (Ohio Commission). Solutions also proposes to

¹ Power Supply Agreement Between FirstEnergy Solutions Corp., Seller and the FirstEnergy Operating Companies, Buyer, FirstEnergy Solutions Corp., FERC Electric Tariff, First Revised Volume No. 1, Service Agreement No. 4 (Ohio Contract) and Electric Power Supply Agreement Between FirstEnergy Solutions Corp., Seller and, Pennsylvania Power Company, Buyer, FirstEnergy Solutions Corp., FERC Electric Tariff, First Revised Volume No. 1, Service Agreement No. 5 (Pennsylvania Contract).

² Under the Commission's Revised Public Utility Filing Requirements, FERC Stats. & Regs. ¶ 31,127 (2002) (Order No. 2001) (codified at 18 C.F.R. § 35.1(g) (2005)), executed market-based power sales agreements are not to be filed.

make power sales to Penn Power for the final year of a Restructuring Plan approved by the Pennsylvania Public Utility Commission (Pennsylvania Commission).³

Background

3. On November 1, 2005, Solutions filed two power supply agreements (the Ohio Contract and the Pennsylvania Contract) for sales to affiliates under section 205 of the Federal Power Act.⁴ Solutions requests that the Ohio contracts be accepted for filing and permitted to become effective without suspension on January 1, 2006.

4. Solutions is a power marketer that is a wholly owned subsidiary of FirstEnergy Corp., a registered public utility holding company. The FE Ohio Operating Companies and Penn Power are direct or indirect subsidiaries of FirstEnergy Corp. Their transmission facilities are under the operational control of the Midwest Independent Transmission System Operator, Inc. (Midwest ISO).

5. The Ohio Contract is a three-year contract proposed to commence January 1, 2006. Solutions' rates for power sales under the Ohio Contract would be the same as the rates that the FE Ohio Operating Companies charge their retail customers for generation service under the Rate Stabilization Plan approved by the Ohio Commission.⁵ Solutions would charge the FE Ohio Operating Companies the same amount that the FE Ohio Operating Companies bill their wholesale customers for power supply. Solutions' charges for wholesale power consist of: (1) a generation charge;⁶ (2) a fuel charge; (3) a Rate Stabilization Charge;⁷ and (4) a pro rata share of spot market purchases.⁸

³ *Pennsylvania Public Utility Commission v. Pennsylvania Power Company; petition for Approval of Restructuring Plan*, Docket No. R-00974149 (approved, 1999 and imposing POLR obligations).

⁴ 16 U.S.C. § 824e (2000).

⁵ *Id.* Article IV and Exhibit B.

⁶ Adjustments to the generation charge are allowed for the costs of fuel (including the cost of emission allowances consumed, lime, stabilizers and the other additives and fuel disposal) and taxes. FES-2, Ohio Commission Case No. 03-2144-EL-ATA, Opinion and Order (June 9, 2004); FES-2, Ohio Commission Case No. 03-2144-EL-ATA, Entry on Rehearing (August 4, 2004) at p. 3

⁷ The Rate Stabilization Charge represents the price for the FE Ohio Operating Companies to accept the risk inherent in the Rate Stabilization Plan. It was set at the
(continued...)

6. The Ohio Commission required FE Ohio Operating Companies to conduct a competitive bidding process to assure that the charges for generation service under the Rate Stabilization Plan do not exceed the long-term market prices that would result from a competitive bidding process. FE Ohio Operating Companies held the first bidding process on December 8, 2004. An independent consultant managed the bidding process, and Ohio Commission retained another independent consultant to monitor and evaluate the competitive bidding process and its results. The bidding process attracted six bidders. The clearing price was 5.45 cents per kWh.⁹ The Ohio Commission found that the Rate Stabilization Plan price was more favorable to customers than the clearing price resulting from the bidding process.¹⁰

7. In Pennsylvania, the retail restructuring process, which includes a generation rate cap, expires on December 31, 2006. Solutions states that the Pennsylvania Contract is a one-year contract that serves as a bridge mechanism to supply power until other mechanisms are in place in Pennsylvania.

8. The Pennsylvania Contract has a generation rate consisting of a capped generation charge and the retail charge for losses billed to Penn Power's retail customers.¹¹ Under the Pennsylvania Contract, Solutions would charge Penn Power the same amount for generation that Penn Power charges its retail customers for generation service. Solutions states that although the Pennsylvania Contract rate was not subjected to a competitive process, the expected generation rate is lower than that resulting from the December 8, 2004 bidding process in Ohio and other competitive auctions in New Jersey and Maryland.

same level as the stranded cost recovery charge. FES-2, Ohio Commission Case No. 03-2144-EL-ATA, Opinion and Order at pp. 22 and 50.

⁸ Ohio Contract, Article IV and Exhibit B.

⁹ FES-3, Ohio Commission Case No. 04-1371-EL-ATA, Finding and Order at P 8 (December 9, 2004).

¹⁰ *Id.*

¹¹ Pennsylvania Contract, Article IV and Exhibit B.

Notice of Filing and Pleadings

9. Notice of Solutions' filing was published in the *Federal Register*, 70 Fed. Reg. 69,334 (2005), with motions to intervene and protests due on or before November 22, 2005.
10. Mittal Steel USA ISG Inc. (Mittal) filed a timely motion to intervene. Ohio Energy Group filed a late motion to intervene.
11. Mittal states that it is not clear whether the proposed agreements satisfy the criteria of *Allegheny Energy Supply Co.*, 108 FERC ¶ 61,082 (2004) (*Allegheny*) or are the result of unfair affiliate preference. We explain the Allegheny guidelines below.
12. Ohio Energy Group is a non-profit entity organized to represent the interest of large industrial and commercial customers in electric and gas regulatory proceedings. Ohio Energy Group members are ratepayers of the FE Ohio operating companies. Ohio Energy Group has a direct and substantial interest in the resolution of the issues in this case. It states that the process by which the buyer forecasts its power supply requirements is of vital importance in providing just, reasonable and reliable power to the end use customers of the FE Ohio operating companies, including the members of Ohio Energy Group. Ohio Energy Group states that the scheduling and system planning process described in the Ohio Contract has insufficient detail to determine whether it is reasonable and is likely to result in just and reasonable electric rates. Accordingly, Ohio Energy Group seeks clarifications and additional detail regarding the scheduling and system planning process.

Discussion

Procedural Matters

13. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F. R. § 385.214 (2005), Mittal's unopposed motion to intervene serves to make it a party to this proceeding. Pursuant to Rule 214(d) of the Commission's Rules of Practice and Procedures, 18 C.F.R § 385.214(d) (2005), the Commission will grant Ohio Energy Group's late-filed motion to intervene given the early stage of the proceeding, the absence of undue prejudice or delay, and Ohio Energy Group's interest in the proceeding.

Hearing Procedures

14. As noted above, Solutions asks the Commission to allow Solutions to make sales to its franchised electric utility affiliates. In order to meet the Commission's

requirements for authorization to make market-based rate sales between affiliates, Solutions offers evidence of the bidding process in Ohio.

15. The Commission has stated that, in cases where affiliates are entering into sales agreements, it is essential that ratepayers be protected and that transactions be above suspicion in order to ensure that the market is not distorted.¹² In *Edgar*, the Commission provided that there are several ways to demonstrate that a buyer has chosen the lowest cost supplier and thus that it has not preferred an affiliate without justification.¹³ *Edgar* provided the following three examples of ways to make this showing: evidence of direct head-to-head competition between the seller and competing unaffiliated suppliers; evidence of the prices that nonaffiliated buyers were willing to pay for similar services from the seller; and benchmark evidence that shows the prices and terms and conditions of sales made by nonaffiliated sellers to the buyer or other buyers in the relevant market.

16. Solutions relies on the bidding process as evidence in support of its requested authorization to supply wholesale power to its affiliated franchised utility in Ohio. However, the evidence provided by Solutions does not satisfy our concerns regarding affiliate abuse. The bidding process on which Solutions relies was not a direct head-to-head competition and is not convincing benchmark evidence, as more fully discussed below.

17. The bidding process that Solutions relies on is not probative for the following reasons. When an entity presents this kind of evidence, *Edgar* requires assurance that: (1) the competitive solicitation process was designed and implemented without undue preference for an affiliate; (2) the analysis of bids did not favor affiliates, particularly with respect to non-price factors; and (3) the affiliate was selected based on some reasonable combination of price and non-price factors.¹⁴

18. In *Allegheny*, the Commission provided guidance as to the standards the Commission will use to evaluate whether a competitive solicitation meets the *Edgar*

¹² See *Boston Edison Co. Re: Edgar Electric Energy Co.*, 55 FERC ¶ 61,382 at 62,167 (1991) (*Edgar*); *Southern California Edison Company, On Behalf of Mountainview Power Company, LLC*, 106 FERC ¶ 61,183 at P 58 (2004) (*Mountainview*).

¹³ *Edgar*, 55 FERC at 62,168-69.

¹⁴ *Id.*

criteria.¹⁵ The *Allegheny* guidelines provide a “safe harbor” that, if met, will result in approval of the requested market-based rate authorization without the need for an evidentiary hearing. As the Commission has stated, the underlying principle when evaluating a competitive solicitation under the *Edgar* criteria is that no affiliate should receive undue preference during any stage of the competitive solicitation. The Commission indicated that the following four guidelines will help the Commission determine if a competitive solicitation satisfies that underlying principle:

- a. Transparency: the competitive solicitation process should be open and fair.
- b. Definition: the product or products sought through the competitive solicitation should be precisely defined.
- c. Evaluation: evaluation criteria should be standardized and applied equally to all bids and bidders.
- d. Oversight: an independent third party should design the solicitation, administer bidding, and evaluate bids prior to the company’s selection.

19. The product definition in the bidding process used here was not consistent with the *Allegheny* guidelines. Here, the bidding process defined a product (all-inclusive price with no tracker for fuel) that was compared to a different product that Solutions would provide (formula rate with a tracker for fuel, spot market purchases and other expenses). In effect, it was a comparison of apples and oranges. Because the product included in the bidding process provided for an all-inclusive rate, bidders faced the risk of volatility in fuel prices, so they probably added a “risk premium” to their bids. The affiliate seller, Solutions, had the advantage of a tracker, so no “risk premium” for fuel and other expenses was needed. Similarly, Solutions had the advantage of a tracker for spot market purchases and the risk inherent in providing a stable price. As one would expect, the product with the higher risk carried a higher price.

20. Nor did the bidding process meet the requirement for transparency. Solutions has not demonstrated that all bidders had equal access to all relevant data such as access to the Rate Stabilization Plan price to bid against. Also, Solutions did not participate in the bidding process, so the bidding process thus did not provide direct head-to-head competition between Solutions and competing unaffiliated suppliers. Further, Solutions’ formula price was not submitted to the bidding process, so competitors had no chance to beat that price.

¹⁵ *Allegheny* at P 22-35.

21. The evaluation principle was not met because the bidding process did not clearly specify the price and non-price criteria based on which the bids would be evaluated. Recognizing that the bidding process was not an apples-to-apples comparison, the Ohio Commission performed the final evaluation of the bids by comparing the final fixed bid to likely values of the Rate Stabilization Plan under assumed levels of fuel prices and other pass-through factors. Based on this evaluation, the Ohio Commission rejected the bidding process clearing price and decided to allow the FE Ohio Operating Companies to purchase capacity and energy from Solutions. However, the record does not indicate that bidders knew the price criteria against which they would be evaluated. They may not have known the assumptions the Ohio Commission would use in estimating Solutions' price. It is also unclear as to whether they knew what weight the Ohio Commission would give non-price factors such as a residential credit (discount) available under the Rate Stabilization Plan. Further, it does not appear that the evaluation considered the fact that the fixed price bidder, in contrast to Solutions, assumed all the risks of changes in fuel and the other variable pass-through costs and would incur the costs of managing this risk.

22. Thus, the Commission's preliminary analysis of Solutions' proposal to make affiliate power sales indicates that it has not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful. Solutions has failed to demonstrate that the proposed affiliate power sales do not provide the parties with the chance for abusive self-dealing. However, there may be other evidence to support Solution's requested authorization. Accordingly, the Commission will accept and suspend Solutions' request to make sales to its affiliates, as discussed herein, subject to the outcome of an evidentiary hearing and subject to refund. In setting this matter for hearing, the Commission affords Solutions an opportunity to demonstrate that there is evidence that satisfies our affiliate abuse concerns as discussed in *Edgar*.

23. While we are accepting and suspending Solutions' request to make sales to its affiliates, subject to the outcome of an evidentiary hearing and subject to refund, we find that accepting the power supply agreements for filing is unnecessary. The Commission's regulations provide that public utilities shall not file with the Commission market-based rate agreements that they negotiate under their market-based rate tariffs.¹⁶

¹⁶ Instead, Order No. 2001, which implemented 18 C.F.R. § 35.1(g) (2005), requires, among other things, that public utilities with market-based rate authority electronically file Electric Quarterly Reports that summarize the terms and conditions in every effective service agreement for market-based power sales.

24. As noted above, Ohio Energy Group seeks clarification and additional detail regarding the scheduling and system planning process set forth in the Ohio Contract. Because it is unnecessary for the Commission to accept the Ohio Contract for filing, we will not address here the issues raised by the Ohio Energy Group.

25. In setting this matter for hearing, it is not the Commission's intention to second-guess state decisions regarding the best way to supply retail load requirements. Instead, we are acting under the FPA to ensure that wholesale rates are just and reasonable and are not unduly discriminatory.

The Commission orders:

(A) Solutions' proposal to make affiliate power sales to its affiliates FE Ohio Operating Companies and Penn Power is hereby accepted, suspended for a nominal period, to become effective January 1, 2006, as requested, subject to hearing and refund as discussed in the body of this order.

(B) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act and by the Federal Power Act, particularly sections 205 and 206 thereof, and pursuant to the Commission's Rules of Practice and Procedure and the regulations under the Federal Power Act (18 C.F.R., Chapter I), a public hearing shall be held concerning the justness and reasonableness of affiliate power sales between Solutions and FE Ohio Operating Companies and between Solutions and Penn Power.

(C) A presiding judge, to be designated by the Chief Judge, shall, within fifteen (15) days of the date of the presiding judge's designation, convene a prehearing conference in these proceedings in a hearing room of the Commission, 888 First Street, N.E., Washington, DC 20426. Such conference shall be held for the purpose of

establishing a procedural schedule. The presiding judge is authorized to establish procedural dates, and to rule on all motions (except motions to dismiss) as provided in the Commission's Rules of Practice and Procedure.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.